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## China, Peoples Republic of

### Product Brief

### China Spirits Market

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**Report Highlights:**

China's spirits sales were \$25.1 billion in 2006, representing 43% of all alcoholic drinks consumed and making it China's number one alcoholic beverage in current value terms. Spirits consumption revolves around baijiu, followed by whiskey and grape brandy. U.S. whiskey and bourbon exports to China grew 118% in 2006, with total sales of \$5.9 million. Foreign spirits currently make up 10% of domestic spirits sales with the greatest growth potential in high-end baijiu, the burgeoning Scottish whiskey sector, and "healthier" spirits alternatives. For U.S. exporters, overcoming market barriers such as a lack of brand awareness and a lack of consumer knowledge about different spirit types are vital to competing against the emerging wine sector and popular beer market. FAS China's Agricultural Trade Offices are available to provide export assistance for U.S. spirits producers.

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### China's Spirits Market: Overview

China's spirits sales were \$25.1 billion in 2006, representing 43% of all alcoholic drinks in current value terms. It remains slightly ahead of beer as China's number one alcoholic beverage in total sales value. Spirits consumption revolves around *baijiu* (a traditional Chinese liquor), followed by whiskey and grape brandy (cognac). *Baijiu* is estimated to make up 70%-90% of spirits sales.

2006 China Alcoholic Beverage Domestic Consumption		
	By Value	By Volume
<b>Spirits</b>	43.3%	9.8%
<b>Beer</b>	40.7%	84.3%
<b>Wine</b>	16.0%	9.8%

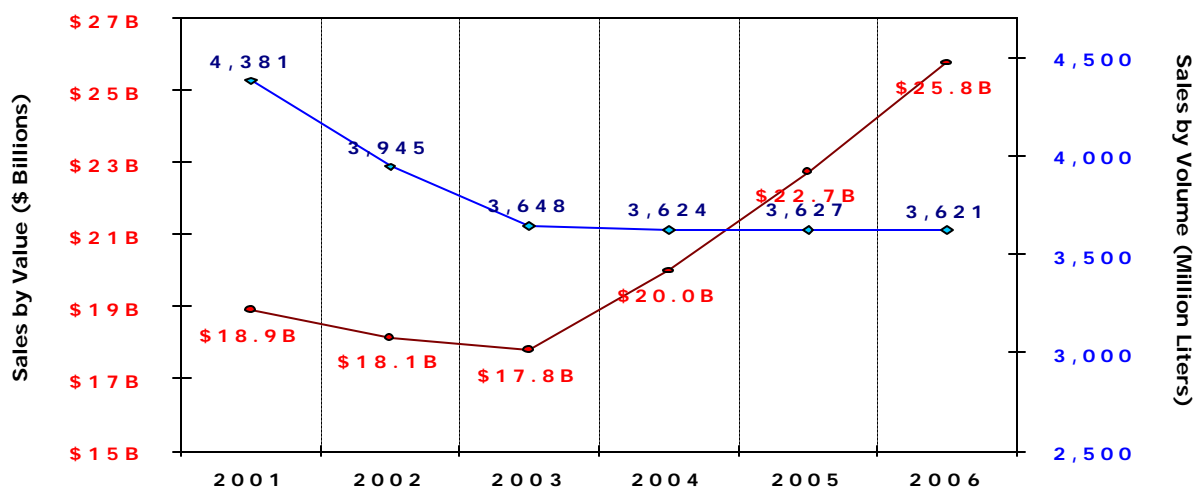
(Source: Euromonitor International)

Globally, China represents the largest consuming nation of spirits by volume and the third largest by current value. China accounts for 20% and 8% of global consumption by volume and value, respectively. At the same time, China ranks much lower in per capita expenditures of spirits, placing outside the top 20 by both consumption measures. Comparatively, populous India ranks 15<sup>th</sup> in per capita expenditures (value) of spirits.

China's per capita rankings are expected to rise, as the rapid growth of the young affluent demographic, its increasing desire for "Western" tastes, and busier lifestyles are creating ever more social opportunities for wine, beer, and spirits consumption. Spirits consumption, however, remains heavily concentrated in the developed metropolitan areas of Northeast and East China.

In recent years, growing health awareness in China -- triggered by SARS, bird flu epidemics, and international food safety issues -- has also brought attention to the harmful affects of excessive spirits consumption, especially those of *baijiu*. The government of China (GOC) has responded by attempting to reduce consumption by increasing the taxation of local spirits and the number of government supported consumer education campaigns.

China Total Spirits Sales: 2001-2006



(Source: Euromonitor International)

Since 2003, spirits consumption by volume has had minimal growth after a 17% decline from 2001-2003. Consumption over the last five years has remained flat between 3,620-3,648 million liters annually. As Chinese consumers move towards beverages with lower alcoholic content, the beneficiaries of the stagnant growth have been light and "green" beers, red wines, and soft drinks. Overall, with greater affluence and health awareness, Chinese are increasingly interested in drinking *better* rather than drinking more.

### **Alcoholic Beverage Demand in China: *Bottoms Up, No Signs of Slowing***

Overall consumer demand for alcoholic beverages continues to be robust and exceed China's economic growth rates. Retail consumer expenditures have grown an average 12.3% annually from 2002-2006, driven largely by large growth rates in the beer and wine sectors. In 2006, overall domestic alcohol consumption totaled \$59.5 billion.

Geographically, the East and Northeast regions dominate overall alcoholic consumption in China, accounting for 28% and 29% of domestic sales by volume in 2006, respectively. Traditionally, the Northeast, with its cooler climate and higher average per capita incomes, has been the largest consumer of spirits. In 2006, it outpaced all other regions, accounting for 33% of sales by current value.

The South China region has experienced the fastest growth domestically, with alcohol sales jumping 13% (value) and 7% (volume) in 2005-2006. Rapidly increasing disposable income levels in the major cities of Guangzhou, Shenzhen, and Dongguan and demand for more sophisticated beverages other than beers have fueled this explosive growth. The sales growth of beer in the region has lagged behind the rest of China. Meanwhile, spirits continue to sell (2% volume growth in 2005-2006) even as other regions have had declines in spirits volume sales. The robustness of South China's spirits market is due to its preference for a variety of spirits, lower demand for local economy spirits (i.e. 2% of spirits sales by volume), and strong preferences for foreign brands.

### **China Spirits Outlook: *Niche Growth Opportunities for High-End Foreign Brands***

The long-term forecast for spirits sales is not as promising as compared to that of the burgeoning wine sector. The China wine sector started booming when average prices dropped following a reduction in wine tariffs from 44.6% to 14% in 2005 to comply with World Trade Organization (WTO) rules. Foreign spirits also enjoyed significant tariff reductions -- from 19.2% to 10% in early 2005 -- but the impact on its market prices has not been as significant as that for wine. In 2006, China revamped its consumption tax code, reducing the rate for hard liquors (spirits) from 25% to 20%.



Over the next five years, industry experts forecast continued, flat spirits growth in volume. This will be offset by double-digit YTY sales growth in current value. These seemingly contradictory forecasts are based on the expectation that Chinese will drink the same volume of spirits but will move from economy local spirits to higher-priced foreign imports. Foreign spirits currently make up 10% of the market.

Enormous growth opportunities continue to exist for foreign imports at the high-end, particularly for whiskey, cognac, and premium *baijiu*. Flavored vodka, white rum, and ready-to-drink spirits (RTDs) including herbal spirits have shown growth potential but are currently consumed at low volumes. The market is ripe for healthier spirits alternatives to *baijiu*, but improving consumer knowledge about non-traditional spirits is needed. Opportunities also exist geographically, with the highest volume growth rates in the South China region.

### Foreign Spirits: *Perceived as a Luxury Good*

Foreign spirits are limited to the premium/luxury end of the spirits industry due to high import taxes, restricted distribution channels, and fierce domestic competition. Luxury goods are highly attractive to wealthy Chinese, who, in general, desire name brand, prestigious goods. Those earning more than \$37,300 annually in China now total 15 million (2006). The size of the urban middle class, a demographic crucial to the continued growth of foreign spirits, ranges in estimates from 65 million - 300 million people.

### U.S. Spirits Exports to China: *All about Whiskey, Sales Up YTY since 2001*

Exports of U.S. spirits to China are dominated by whiskey (including bourbon), comprising 79% of the category's export value (\$5.9 million, 2006) and 75% of its export volume between 2002-2006. Nearly all U.S. whiskey exports to China arrive in bottled form (as opposed to bulk) in containers no greater than 1 gallon (4 liters). Overall, the U.S. ranks third behind the U.K. and Canada in global whiskey exports, with sales up 17% in 2006.

U.S. spirits exports to China, excluding Hong Kong, saw a robust 73% volume growth from 2005-2006, far outpacing the sector's general export growth rate of 17%. The drop in Hong Kong's export volume during the same period is likely due to more shipments heading directly to the mainland after spirits tariffs were reduced in 2005.

While U.S. whiskey holds the dominant position among U.S. spirits exports to China, it faces a fierce battle with other foreign whiskey products, particularly blended and malt Scotch whiskey, which have made enormous market gains in recent years. The popularity of blended Scotch, in particular, vaulted China in 2006 into a top ten whiskey-drinking nation with total sales of \$115 million.

U.S. Exports by Volume - Whiskey, Bourbon (Proof Gallons)				
		2006	2005	% -
1	Australia	6,424,408	5,424,328	18%
2	U. Kingdom	2,831,226	2,790,932	1%
3	Germany	2,766,416	2,454,189	13%
4	Japan	2,184,730	1,784,580	22%
5	Canada	1,559,848	742,866	110%
6	N. Zealand	1,268,520	1,219,975	4%
7	France	872,447	825,710	6%
8	Spain	669,077	449,486	49%
9	South Africa	494,909	494,277	0%
10	Italy	479,023	403,500	19%
11	Hong Kong	249,460	358,418	-30%
12	China	225,075	130,007	73%
	All Countries	22,778,529	19,484,841	17%

(Source: U.S. Distilled Spirits Council)

U.S. whiskey exports sell for the second highest average price (\$6.88 / liter, 2006) among all traded spirits. As such, its mid-term prospects for the highest growth rates remain the most favorable. Rum and tafia remain a distant second in current value among U.S. spirits exports. Vodka exports have significantly decreased in the last two years.

### U.S. Spirits Exports to China: Market Shares by Sector

Value (% of Market)	2002	2003	2004	2005	2006	2007 YTD
(HS220830) Whiskies	54.0%	67.4%	82.8%	79.8%	79.3%	53.7%
(HS220890) Other	4.3%	18.7%	2.9%	7.5%	10.0%	15.0%
(HS220840) Rum & Tafia	38.0%	1.0%	0.1%	8.3%	5.2%	12.0%
(HS220870) Liquors/Cordials	3.2%	6.4%	0.4%	0.3%	4.0%	4.6%
(HS220820) Grape Brandy	0.5%	6.5%	1.3%	N/A	1.2%	11.3%
(HS220860) Vodka	N/A	N/A	5.9%	1.4%	0.2%	3.5%
(HS220850) Gin & Geneva	N/A	N/A	N/A	N/A	0.1%	N/A

Volume (% of Market)	2002	2003	2004	2005	2006	2007 YTD
(HS220830) Whiskies	45.7%	52.4%	60.6%	69.5%	75.4%	54.2%
(HS220890) Other	5.5%	32.2%	4.1%	11.5%	7.0%	10.2%
(HS220840) Rum & Tafia	46.3%	2.1%	0.2%	11.2%	7.3%	16.0%
(HS220870) Liquors/Cordials	1.7%	6.4%	6.1%	4.9%	7.1%	4.9%
(HS220820) Grape Brandy	0.7%	6.8%	1.9%	N/A	2.7%	12.2%
(HS220860) Vodka	N/A	N/A	27.1%	2.9%	0.3%	2.4%
(HS220850) Gin & Geneva	N/A	N/A	N/A	N/A	0.1%	N/A

In general, the retail prices of spirits in China have become more expensive in 2006-2007 due to the higher cost of ingredient materials and a high consumption tax. As of July 2007, the average retail price of a 700 ml bottle of Kentucky bourbon (whiskey) ranged from \$25 - \$40, depending on the retail outlet.

#### U.S. Spirits Exports to China: Average Prices by Sector

Average Price (\$ / Liter)	2002	2003	2004	2005	2006	2007 YTD
(HS220830) Whiskies	\$4.25	\$4.56	\$5.18	\$5.19	\$6.88	\$6.70
(HS220890) Other	\$2.81	\$2.06	\$2.69	\$2.96	\$9.31	\$9.91
(HS220840) Rum & Tafia	\$2.96	\$1.79	\$2.02	\$3.33	\$4.62	\$5.04
(HS220870) Liquors/Cordials	\$6.92	\$3.53	\$4.35	\$2.74	\$3.67	\$6.30
(HS220820) Grape Brandy	\$2.51	\$3.37	\$2.66	N/A	\$2.96	\$6.26
(HS220860) Vodka	N/A	N/A	\$0.83	\$2.23	\$3.76	\$9.63
(HS220850) Gin & Geneva	N/A	N/A	N/A	N/A	\$5.39	N/A

(Source: U.S. Customs Data, U.S. Department of Commerce)

#### Competitor Spirits Exporters to China

Foreign spirits constitute 10% of the total spirits market. Foreign competition is dominated by UK-produced Scottish whiskey (\$94.8 million, 2006) and French grape brandy, which includes cognac (\$233 million, 2006). Remy Martin and Martell (parent company is France's Pernod Ricard Group) hold the top two positions in cognac exports to China.

The UK's dominant position in whiskey is led by Scottish Chivas Brothers (the parent company is also Pernod Ricard Group), which produces Chivas Regal, the number one whiskey product in China. Chivas sales volume increased 60% in 2006, thanks to the highly successful "This is the Chivas Life" national marketing campaign. Chivas Regal mixed with green iced tea has proven to be extremely popular in up-scale nightclubs.

UK-based Diageo, the world's largest alcoholic beverage company, is a holding company to many popular foreign imports in China, including Scotch whiskey brands Johnnie Walker Black Label and Ballantines, the number two and three whiskey products in China. Operating in China since 1995, Diageo operates a marketing and distribution joint-venture Moët Hennessy (LVMH) of France under the name MHD Moët Hennessy Diageo Co Ltd.

India-based United Spirits, owned by the UB Group and the number three global spirits producer, has recently announced that it will enter the Chinese market beginning in the East China region.

Overall, the Pernod Ricard Group holds a 42% market share among total foreign imported whiskey, vodka, and cognac sales, compared to a 17% for Moët Hennessy Diageo.

Other foreign spirits with sizeable exports include Japanese spirits (\$1.4 million, 2006), Russian vodka (\$2.6 million, 2006), and Korean soju (\$3.5 million, 2006).



## Locally Produced Spirits



*Maotai, a popular Baijiu brand produced in Guizhou province*

*Baijiu*, a “white liquor”, is the most popular local spirits in China and the world’s best selling spirit by volume. Often confused as a white wine, this grain-based white spirit is considered the national drink. *Baijiu* is comparable in taste and potency (80 to 120 proof) to Russian vodka and affectionately called the “Chinese vodka”. Alcohol consumption in rural parts of China, with an estimated 700 million inhabitants, is primarily limited to beer and *baijiu*.

The distillation process for an average *baijiu* brand is only one pass -- as opposed to 4-5 passes for vodka -- giving it its strong, biting flavor. The best quality *baijiu*, distilled from sorghum, rice, unhusked barley and other local cereals, comes from the Sichuan province in Southwest China, home to three of the top four producing brands. Other main production regions include Shandong, Guizhou, and Hunan.

High-end *baijiu* is consumed among the male-dominated business community, during Chinese holidays such as Chinese New Year’s and Military Day, and during popular festivals such as the Spring and the Dragon Boat Festivals. The *Maotai* brand (particularly the 52% proof version) is traditionally consumed at official state banquets and military celebrations. Today, the widespread availability of low-grade economy *baijiu* in convenience stores has made it accessible year-round at a low cost. In Beijing and Shanghai, an eight-ounce bottle of *baijiu* costs as much as a can of domestic beer (RMB 2 / \$0.26).

Well-aged, higher-grade *Baijiu*, however, sells at a premium at prices comparable to those of vintage wines. For example, a 500 ml bottle of premium-grade top brand *baijiu* sells for an average price of \$38. *Baijiu* sales have averaged 20% YTY growth (value) over the last fifteen years and are expected to grow 15% YTY in the next five years.

*Baijiu* is one of the few remaining Chinese industries in which foreign capital has yet to enter. In December 2006, Diageo became the first foreign spirits company to significantly invest in the Chinese spirits industry after it took a minority stake in a top *baijiu* producer. This has marked the beginning of a series of foreign investments and joint ventures with Chinese *baijiu* producers, as foreign spirits companies seek entry into the lucrative premium *baijiu* market.

Overall, no more than two Chinese spirits producers can legitimately claim to be a national brand. Both are positioned at the premium end, compete directly against foreign imports, and have developed prestigious brands. *Sichuan Yibin Wuliangye* is the largest such national producer, competing against foreign imports and invests heavily in product development, advertising, and promotions. *Kweichow Moutai Yunfeng* is also considered an equally popular national producer with a presence in all major

Top Spirits Producers by Region		
Region	Foreign Producers	Local Producers
East China	PRC Chivas Regal Diageo (JW)	Sichuan Yibin Wuliangye Kweichow Moutai Yunfeng
Central China	<i>Minimal</i>	Sichuan Yibin Wuliangye Sichuan Tuopai Yeast Liquor
Northeast China	PRC Chivas Regal Diageo	Sichuan Yibin Wuliangye Kweichow Moutai Yunfeng Lang Jiu Group
Northwest China	PRC Chivas Regal Martell VSOP LVMH Hennessy	Sichuan Yibin Wuliangye Kweichow Moutai Lang Jiu
South China	<i>Minimal</i>	Sichuan Yibin Wuliangye Yantai Changyu Jiujiang Shuang Zheng
Southwest China	PRC Chivas Regal	Sichuan Yibin Wuliangye Kweichow Moutai Yunfeng Sichuan JianNanChun

markets except for the South China region.

The lower and mid levels of the Chinese spirits market are much more fragmented. In total, China has over 18,000 liquor makers (2006), down from 37,000 in 1989. Of the companies that dominate this segment, most only target a single region. As examples, the Beijing General Distillery is the market leader for local economy spirits in the Northeast China; the *Jiangsu Shuanggou* and *Shangdon JingZhi* are top regional brands in East China; and *Luzhou Laojiao* and *Wanjiu Wang* are popular mid-level *baijiu* products in South China, particularly Zhongshan and Dongguan.

A major reason for the lack of a dominant economy spirits company is the weak infrastructure between rural areas and production centers. The growing income inequality problem in China also exacerbates market segmentations and, consequently, the difficulty in developing a national economy spirits brand. The growing health awareness has impacted regional spirits players the worst, as “health taxation” has reduced the affordability of its products, forcing consumers to shift to alternative alcoholic beverages.

### Regional Market Differences: *Differences Based on Tastes and Local Production*

China's vast size and scope presents problems for foreign producers looking to enter the market. Depending on the goals of the producer, most foreign spirits entrants target the Northeast and East regions to reach the Beijing and Shanghai markets. However, strong growth opportunities now exist in the South region for a number of reasons. The market is geographically far from the main *baijiu* production centers in the Southwest. Second, there is strong demand for more sophisticated drinks (wines and spirits), away from the saturated beer market. Guangzhou is viewed as a good entry point for spirits distribution.

The Central and Northwest China regions remain difficult markets for high-end foreign spirits to enter due to low per capita incomes, a market saturation of local economy spirits, a lack of foreign brand awareness, and fewer retail channels. In addition, these less developed regions are more tied to traditional tastes like *baijiu* and beer and more adverse to switching to “exotic”, pricier foreign spirits like vodka, rum, and cognac.

### SWOT Analysis for U.S. Spirits Exporters by China Region

Region	Strengths	Weaknesses	Opportunities	Threats
East China	- Excellent Distribution - Economic / Port Hub	- Fierce Competition - Franchise Dependence	- Increased Taxation on Low / Mid-Priced Spirits	- Premium Local Spirits - Wine
Central China	- Large Consumer Base - Good Transportation Network	- Weak Foreign Brands - Few Chain Retailers - Price Sensitive Market	- Few Premium Players - Premium Whisky & White Spirits	- Rice Wine
Northeast China	- Largest Volume Sales - Political / Economic Hub - Growth in Retail Sales	- Local Spirits Dominate (99% Market Share) - Restaurant / Bar Focus	- Healthy Spirits - Up-Market Spirits Sales - Whisky / White Spirits	- Abundant Counterfeits - Rice Wine - Premium Wine & Lager
Northwest China		- Lowest Sales Growth - Low Demand/Unaware - Poor Distribution	- Healthy Spirits - Too Many Local Brands	- Red Wine - Beer - Spirits Consolidation
South China	- Best Volume Growth - Popularity of Cognac - Knowledge of Spirits	- Local Makers Dominate - Wine Popularity	- Malt / Scotch Whisky - Cognac - Ready-to-Drink Spirits	- Wine - Domestic Beer Produced Here
Southwest China	- High Macro investment - Strong Foreign Brand Awareness in Cities	- Most Local Spirits Produced Here - Focus out of Big Cities	- Super-Premium - Supermarket Access	- Beer

(Note: Glossary at the end of this report lists provinces in each region)

**Growing Health Awareness: *Spirits Perceived as Unhealthy More than Ever***

Chinese consumers' growing health awareness is one major reason for the decline in volume sales over the last five years. In 2005, the GOC aimed to reduce excessive spirits consumption by increasing consumption taxes for local economy spirits made of potato. The growing perception that economy local spirits, principally *baijiu*, are unhealthy has led to many consumers to move towards lower alcoholic content beverages instead of moving up-market to higher-grade premium / foreign spirits.

Overall, the beneficiaries have been red wines -- for their perceived benefits with cardiovascular health -- and to a lesser extent traditional rice wines, light beers, new "green" beers, and non-alcoholic drinks. Chinese herbal spirits have benefited, too, as they are perceived as a healthier alternative. Sales volume grew 23% in 2005-2006 and 221% from 2001-2006. Herbal spirits made from Jing Brand have become especially popular gifts for older friends and relatives.

**Spirits Distribution: *Retail Channels Lead the Way***

Retail sales dominate the spirits market, occurring mainly in supermarkets (56%) and, secondarily, in specialist retailers (16%) and independent food stores (15%). The proliferation of low-cost hypermarkets such as Wal-mart and Carrefour are providing more one-stop distribution channels, even for high-end spirits.

For specialist retailers, spirits represent over 80% of total sales. Using personal ties to the local community and benefiting from a long-standing reputation as a trusted seller, specialist retailers act as an important gateway between foreign spirits and traditional, older buyers. As China lacks a national spirits chain, supermarkets and specialists will continue to dominate the retail channel.



*A typical wine, spirits, and tobacco specialist retailer store in Beijing*

Spirits enjoy more sales via the retail route than any other major alcoholic beverage sector except cider/perry for several reasons. Spirits, especially imports, are often perceived as a luxury high-status item, worthy of gift giving, especially during Chinese holidays. In addition, local restaurants, bars, and nightclubs have come to rely and trust local specialist retailers to supply its beverage needs at discounted, wholesale-like prices.

Markups by retailers differ by spirits product, brand, and retailer but range from 15% to 40% -- much higher than those for wine and beer (5% to 10%).

**Marketing and Promotion: *Traditional Media Regulations Not Overly Restrictive***

Since 1996, the GOC has regulated the amount of advertising on traditional media outlets for alcoholic beverage producers. These regulations do not appear to adversely impact the marketing options for foreign spirits producers.

Specifically, for television, no more than two advertisements are permitted per manufacturer per channel during the primetime hours of 19:00 to 21:00, with a limit of ten advertisements per channel daily. Similarly, television channels are not permitted to sell



more than two spirits advertisements per hour. Note that beer and wine are exempt from these restrictions. For print media including newspapers and magazines, no more than two advertisements per manufacturer are allowed in a single issue. Front-page and cover advertisements are prohibited.

In general, foreign spirits without a brand presence in China must complement traditional brand campaigns with product placements in bars, hotels, karaoke clubs, and nightclubs and sponsorship deals. Past sponsorship deals with foreign brands have included Formula One grand prix races, America's Cup yacht competitions, and matches of local sports leagues.

Spirits consumption in China remains a luxury only available to a small percentage. Foreign brands continue to be limited to this segment due to the popularity of *baijiu* and the fierce competition of local producers at the economy spirits level. However, even within the premium end of *baijiu*, the top two producers, Wuliangye and JianNanChu, spent an estimated \$140 million and \$70 million, respectively, on advertising in 2006.

Overall, the high-end spirits market is extremely brand sensitive. Foreign producers with well-known global brands may find themselves having to build brand awareness from ground zero in China. Beyond price and availability, Chinese consumers are switching from *baijiu* to non-spirits due to a lack of knowledge about other spirits. Producers must promote alternative spirits like flavored/light rum and vodka as "healthier" options with lower alcohol content. New entrants may need to initially invest its marketing dollars to educate consumers, bartenders, and food & bar managers not only about its brand but also about its general spirit category -- specifically, its use and application in mixed drinks.

Lastly, foreign producers should seek strong relationships with chain supermarkets and specialist retailers. As these two groups dominate the retail channels, they can help provide the legwork in distributing to local restaurants, bars, karaoke clubs, and nightclubs.

*FAS China's Agricultural Trade Offices can also help U.S. producers promote products at popular trade shows including Bar & Restaurant, China Chain Store Expo, China Alcoholic Drinks Expo, Food & Hotel China (FHC), and SIAL China. Refer to the end for contact info.*

### **Seasonality: Spirits Consumption High during Holidays/Festivals**

Not surprisingly, spirits consumption is seasonal, with sales boosts during the two largest holidays -- Chinese Lunar New Year's in January/February and the Chinese Labor Week in early May. Trade figures show that over the last six years, U.S. spirits exports were highest in volume terms in Q1 and Q2, quarters that correspond with the holidays. Average prices also are higher during winter months.

<b>Total U.S. Spirits Exports to China (HS2208) Quarterly Averages (Q2 2001 to Q1 2007)</b>				
<b>Quarter</b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>
Value (\$ Millions)	1.025	0.827	1.050	0.937
Volume (Liters)	205,820	217,926	185,861	194,690
Average Price (\$ / Liter)	\$5.24	\$4.97	\$4.57	\$5.59

(Source: U.S. Trade Data, U.S. Department of Commerce)

### **Import Taxes on Spirits: Recent Tax Cuts Leveling the Playing Field**

Import taxes for foreign spirits containing less than 80% alcohol content by volume are subject to the same tariff rates. Total import taxes are based on three specific taxes: the

import (customs) tax, VAT, and a consumption tax. As of July 2007, the individual tax rates for foreign spirits products were as follows:

	Import Tax	VAT	Consumption Tax
<b>Spirits</b>	<b>10%</b>	<b>17%</b>	<b>20%</b>
Grape Wine: Containers < 2L (Bottles)	14%	17%	10%
Grape Wine: Containers > 2L	20%	17%	10%
Beer: Unbranded or MSP < RMB 3,000 (\$400)	0%	17%	RMB 220 (\$29) / ton
Beer: MSP > RMB 3,000 (\$400)	0%	17%	RMB 250 (\$33) / ton

(Sources: 2007 Customs Import and Export Tariff of the People's Republic of China, Euromonitor International, Foreign Agricultural Service)

The effective tax rate is not as simple as a summing up the three individual tax rates. Refer to Appendix B ("Formula to Determine Import Tax for Wine") in GAIN Report CH6809 (<http://www.fas.usda.gov/gainfiles/200606/146208112.doc>) as a guideline for calculating the effective tax rate for spirits.

In early 2005, the import (customs) tax which was reduced from 19.2% to 10% in order to comply with WTO rules.

On April 1, 2006, the consumption tax for foreign distilled alcohol was reduced from 25% to 20%. This change was meant to unify all spirits under the same consumption tax rate. On the surface, it appears to be a favorable change for the competitiveness of foreign spirits. It not only reduces the tax rate but also increases it for spirits made from potatoes, which are primarily produced locally. However, if the GOC is concerned that domestic spirits products are being adversely affected by increased foreign sales, a hike in the consumption tax is the most likely mechanism by which the GOC would protect Chinese spirits.

Note also that Hong Kong faces more regional competition from spirits sold in Macao and the mainland. Hong Kong's import taxes for spirits remain considerably higher.

### **Taxes on Domestic Producers**

Domestic spirits distillers are subject to an income tax of 33%, a 17% VAT (same for importers), and a 20% consumption tax (same for importers). The actual amount paid in consumption taxes by Chinese producers is estimated to be 10-15%. Chinese spirits producers looking to export also receive an export rebate of 13%.

### **China's Classification of Alcoholic Beverages: Upcoming Revisions**

In the second half of 2007, China is expected to announce changes to the classification of alcoholic beverages (GB/T 17204-2006). Based on draft versions of the new standard, China proposes to eliminate "restrictions on the requirement for the upper limit for alcoholic beverages and the regulation on the amount of alcohol content in the definition of fermented alcoholic drinks and distilled spirits." Thus, the regulation on the alcoholic content range for brandy, vodka, rum, and whiskey will be canceled. Based on the current classification (GB/T 17204-1998), distilled spirits are categorized as "alcoholic beverages with 18% by volume ~ 60% by volume of alcoholic strength."

The impact of the new standard is that it allows distilled spirits with a higher concentration of ethanol alcohol into the marketplace, as well as "lighter" lower alcohol content spirits, particularly RTDs and flavored (blended) spirits.

The new classification also proposes that "the aging period of malt whiskey is changed to two years", and "juniper-flavored [sic] spirit drinks (gin) is added" as an alcoholic beverage.

*(Source: National Standard of the People's Republic of China, GB/T 17204-2006 Draft, Issued by the General Administration of Quality Supervision, Inspection, and Quarantine, AQSIQ, of the People's Republic of China)*

### Labels for Spirits

China requires a number of labeling requirements, including translation into Chinese, for all pre-packaged foods. For full details on China's labeling requirements as they apply to spirits, refer to the translated versions of the "National Standard for Labeling of Pre-Packaged Foods" and the "General Standard for the Labeling of Prepackaged Alcoholic Beverages":

*GB10344 Labeling Prepackaged Alcoholic Beverages* (GAIN Report CH5006, 01/21/2005)  
<http://www.fas.usda.gov/gainfiles/200501/146118532.pdf>

*GB7718-2003 Food Labeling Standard* (GAIN Report CH4026, 07/30/2004)  
<http://www.fas.usda.gov/gainfiles/200502/146118826.pdf>

In 2006, the China inspection agency (AQSIQ) modified the regulations involving the label approval process for imported and exported products. Effective April 1, 2006, labels no longer must be pre-approved. Approval of labels now can be conducted during the import inspection process at the port of entry. For more information, refer to the following GAIN report:

*China Streamlines Food Label Approval Process* (GAIN Report CH6020, 04/19/2006)  
<http://www.fas.usda.gov/gainfiles/200604/146187516.pdf>

Note that aforementioned changes to the classification of alcoholic beverages may invoke a revision to the label standards for prepackaged alcoholic beverages. FAS China will provide updates to any such changes through its GAIN reports.

Note: Bottled liquor is sold in two standard retail sizes in China: 350 ml and 750 ml. The latter size is more commonly sold at restaurants and nightclubs.

### Counterfeits / Intellectual Property Rights (IPR)

Counterfeiting remains a significant problem in China for high-end foreign spirits. The most common reported counterfeit method is when a manager, retailer, or a smuggler refills an empty premium foreign spirits bottle with a cheaper spirit. As Chinese spirits consumers still are relatively new to the spirits market, they may not be able to discern the different grades in quality. In addition, producing fake labels and bottles is a common practice.

FAS China recommends that spirit exporters take appropriate legal measures to protect against IPR infringements. Foreign producers are advised to trademark logos and brand names, as well as special trademarks such as geographical indications and collective and certification trademarks. The IPR office of FAS China has developed an introductory guide to the trademark registration process in China and can help assist exporters with navigating IP issues. Refer to the following GAIN report for more details:

*Protect Your Trademark... before Someone else Trades your Mark* (GAIN Report CH7035, 05/31/2007)

<http://www.fas.usda.gov/gainfiles/200705/146291256.pdf>

For further assistance on intellectual property issues, contact the IPR office of FAS China:

Mailing Address: Agricultural Trade Office US Embassy Beijing PSC 461 Box 50 FPO AP 96521-0002	Physical Address: Agricultural Trade Office, Beijing Kerry Center, South Tower 24th Floor Suite #2425 No. 1 Guanghua Lu, Beijing 100020
Tel: (86-10) 8529-6418	Fax: (86-10) 8529-6692
E-mail: ChinaIPR@fas.usda.gov	

### SWOT Analysis: China's Spirits Market

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>• Less time to cook at home + more disposable income → changing lifestyle: more dining out and socializing activities → more alcoholic drink / spirits consumption</li> <li>• Sales growth (value) from 2001-2006 ↑ YTY</li> <li>• Foreign spirits symbolize luxury, prestige, and high social status, Chinese value</li> <li>• Incredible growth rates of Scotch whiskey and cognac, led by urban youth</li> <li>• Foreign spirits readily available in supermarkets and specialist retailers in major cities</li> <li>• Foreign spirits remain a desired gift item, especially during holidays and festivals</li> </ul>	<ul style="list-style-type: none"> <li>• Volume sales flat due to increased health awareness, move towards beer and wine</li> <li>• <i>Baijiu</i> consumption is culturally ingrained and readily affordable at low cost</li> <li>• Lack of mainstream awareness about non-traditional spirits (rum &amp; tafia, vodka, cordials, gin).</li> <li>• High prices of foreign spirits make it unaffordable to average Chinese consumer</li> <li>• Combined import taxes prevent foreign spirits from competing on price or introducing lower cost products</li> <li>• Distribution channels limited to supermarkets and specialist retailers.</li> <li>• Rural spirits consumption largely beer &amp; <i>baijiu</i></li> </ul>
Opportunities	Threats
<ul style="list-style-type: none"> <li>• Marketing other spirits as a "healthier" alternative to low-grade local economy spirits</li> <li>• Premium <i>baijiu</i> market still in its infancy</li> <li>• Flavored drinks (vodka/rum) for women</li> <li>• Healthy spirits like herbal RTDs for older drinkers</li> <li>• Branding/educating the average drinker about spirits outside of <i>baijiu</i> and whiskey</li> <li>• South China region = highest spirits growth</li> <li>• Joint ventures or investments with smaller <i>baijiu</i> producers</li> </ul>	<ul style="list-style-type: none"> <li>• Perception that all spirits are equally unhealthy (i.e. <i>baijiu</i> and flavored rum have the same level of alcohol content)</li> <li>• Red wine becoming preferred alternative to those switching from <i>baijiu</i> or moving up-market from beer</li> <li>• Consumption tax could be raised if domestic producers are adversely affected by foreign spirits</li> <li>• Counterfeiting by refilling empty foreign bottles and reusing labels</li> </ul>

**FAS China Agricultural Trade Offices**

U.S. spirits producers seeking to export and promote its products in China should contact the appropriate Agricultural Trade Office for export assistance:

<p>Agricultural Trade Office, Beijing  Kerry Center, South Tower  24th Floor Suite #2425  No. 1 Guanghua Lu, Beijing 100020  Tel: (86-10) 8529-6418  Fax: (86-10) 8529-6692  Email: <a href="mailto:ATOBeijing@usda.gov">ATOBeijing@usda.gov</a></p>	<p>Agricultural Trade Office, Shanghai  U.S. Consulate General, Shanghai  Shanghai Centre, Suite 331  1376 Nanjing West Road  Shanghai, China 200040  Tel: (86-21) 6279-8622  Fax: (86-21) 6279-8336  Office Email: <a href="mailto:ATOShanghai@usda.gov">ATOShanghai@usda.gov</a></p>
<p>Agricultural Trade Office, Guangzhou  U.S. Consulate General, Guangzhou  China Hotel Office Tower 14/F  Guangzhou, China 510015  Tel: (86-20) 8667-7553  Fax: (86-20) 8666-0703  Office Email: <a href="mailto:ATOGuangzhou@usda.gov">ATOGuangzhou@usda.gov</a></p>	<p>Agricultural Trade Office, Chengdu  Opening August 2007  Office Email: <a href="mailto:ATOChengdu@usda.gov">ATOChengdu@usda.gov</a></p> <p>Agricultural Trade Office, Shenyang  Opening 2008  Office Email: Contact <a href="mailto:ATOBeijing@usda.gov">ATOBeijing@usda.gov</a></p>



## Glossary

In this report, certain region names are often used as short hand for a cluster of provinces and municipalities by geographic area. The following lists these associations:

East China: Anhui, Jiansun, Shanghai (municipality), Shandong, Zhejiang

Central China: Henan, Hubei, Jiangxi

Northeast China: Beijing (municipality), Hebei, Heilongjiang, Jilin, Liaoning

Northwest China: Gansu, Qinghai, Shaanxi, Shanxi

South China: Fujian, Guangdong, Hainan

Southwest China: Chongqing (municipality), Guizhou, Sichuan, Yunnan



**Appendix I. U.S. Alcoholic Beverage Exports to China**

(HS2203 Beer, HS2204 Wine, HS2205 Vermouth, HS2207 &gt;80% Liquor, HS2208 Spirits)

Value (\$ Million)	2002	2003	2004	2005	2006	2007 YTD
<b>Eth Alc, Undnat&lt;80Alc</b>	<b>2.044</b>	<b>2.377</b>	<b>2.722</b>	<b>3.373</b>	<b>7.387</b>	<b>1.158</b>
Wine Of Fresh Grapes	3.370	2.576	5.398	5.914	9.283	3.207
Beer Made from Malt	0.039	0.315	0.021	0.091	0.221	0.088
Ethly Alco Etc>80% Alc	1.142	0.075	0.228	0.381	0.247	0.023
Flavr Wine,Vermouth	N/A	N/A	0.126	0.075	N/A	N/A

Value (% Growth - )	2003	2004	2005	2006
<b>Eth Alc, Undnat&lt;80Alc</b>	<b>16.3%</b>	<b>14.5%</b>	<b>23.9%</b>	<b>119.0%</b>
Wine Of Fresh Grapes	-23.5%	109.5%	9.6%	57.0%
Beer Made from Malt	700.6%	-93.4%	340.2%	142.9%
Ethly Alco Etc>80% Alc	-93.5%	205.3%	66.8%	-35.1%
Flavr Wine,Vermouth	N/A	N/A	-40.5%	N/A

Value (% of Market)	2002	2003	2004	2005	2006	2007 YTD
<b>Eth Alc, Undnat&lt;80Alc</b>	<b>31.0%</b>	<b>44.5%</b>	<b>32.0%</b>	<b>34.3%</b>	<b>43.1%</b>	<b>25.9%</b>
Wine Of Fresh Grapes	51.1%	48.2%	63.5%	60.1%	54.2%	71.6%
Beer Made from Malt	0.6%	5.9%	0.2%	0.9%	1.3%	2.0%
Ethly Alco Etc>80% Alc	17.3%	1.4%	2.7%	3.9%	1.4%	0.5%
Flavr Wine,Vermouth	N/A	N/A	1.5%	0.8%	N/A	N/A

Volume (Liters)	2002	2003	2004	2005	2006	2007 YTD
<b>Eth Alc, Undnat&lt;80Alc</b>	<b>567,363</b>	<b>669,337</b>	<b>717,697</b>	<b>746,292</b>	<b>1,130,126</b>	<b>386,592</b>
Wine Of Fresh Grapes	2,536,988	1,286,476	2,142,479	2,338,472	3,472,043	1,795,379
Beer Made from Malt	52,148	596,293	29,611	124,942	183,049	202,866
Ethly Alco Etc>80% Alc	N/A	N/A	N/A	N/A	N/A	N/A
Flavr Wine,Vermouth	N/A	N/A	137,553	32,652	N/A	3,840

Volume (% Growth - )	2003	2004	2005	2006
<b>Eth Alc, Undnat&lt;80Alc</b>	<b>18.0%</b>	<b>7.2%</b>	<b>4.0%</b>	<b>51.4%</b>
Wine Of Fresh Grapes	-49.3%	66.5%	9.1%	48.5%
Beer Made from Malt	1043.5%	-95.0%	321.9%	46.5%
Ethly Alco Etc>80% Alc	N/A	N/A	N/A	N/A
Flavr Wine,Vermouth	N/A	N/A	-76.3%	N/A

Volume (% of Market)	2002	2003	2004	2005	2006	2007 YTD
<b>Eth Alc, Undnat&lt;80Alc</b>	<b>18.0%</b>	<b>26.2%</b>	<b>23.7%</b>	<b>23.0%</b>	<b>23.6%</b>	<b>16.2%</b>
Wine Of Fresh Grapes	80.4%	50.4%	70.8%	72.1%	72.6%	75.2%
Beer Made from Malt	1.7%	23.4%	1.0%	3.9%	3.8%	8.5%
Ethly Alco Etc>80% Alc	N/A	N/A	N/A	N/A	N/A	N/A
Flavr Wine,Vermouth	N/A	N/A	4.5%	N/A	N/A	N/A

Avg. Price (\$/Liter)	2002	2003	2004	2005	2006	2007 YTD
<b>Eth Alc, Undnat&lt;80Alc</b>	<b>\$3.60</b>	<b>\$3.55</b>	<b>\$3.79</b>	<b>\$4.52</b>	<b>\$6.54</b>	<b>\$6.76</b>
Wine Of Fresh Grapes	\$1.33	\$2.00	\$2.52	\$2.53	\$2.67	\$2.70
Beer Made from Malt	\$0.75	\$0.53	\$0.70	\$0.73	\$1.21	\$1.23
Ethly Alco Etc>80% Alc	N/A	N/A	N/A	N/A	N/A	N/A
Flavr Wine,Vermouth	N/A	N/A	\$0.91	\$2.29	N/A	\$1.56

Avg. Price (% Growth - )	2003	2004	2005	2006
<b>Eth Alc, Undnat&lt;80Alc</b>	<b>-1.4%</b>	<b>6.8%</b>	<b>19.3%</b>	<b>44.7%</b>
Wine Of Fresh Grapes	50.4%	26.0%	0.4%	5.5%
Beer Made from Malt	-29.3%	32.1%	4.3%	65.8%
Ethly Alco Etc>80% Alc	N/A	N/A	N/A	N/A
Flavr Wine,Vermouth	N/A	N/A	151.6%	N/A

(Source: U.S. Trade Data, U.S. Department of Commerce)

**Appendix II. U.S. Spirits Exports to China**

(HS2203 Beer, HS2204 Wine, HS2205 Vermouth, HS2207 &gt;80% Liquor, HS2208 Spirits)

<b>Value (\$ Million)</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007 YTD</b>
(HS220830) Whiskies	1.103	1.602	2.253	2.692	5.859	1.403
(HS220890) Other	0.088	0.445	0.079	0.254	0.739	0.393
(HS220840) Rum & Tafia	0.777	0.025	0.003	0.279	0.382	0.313
(HS220870) Liqueurs/Cordials	0.065	0.152	0.012	0.010	0.296	0.119
(HS220820) Grape Brandy	0.011	0.154	0.036	N/A	0.090	0.295
(HS220860) Vodka	N/A	N/A	0.160	0.049	0.013	0.091
(HS220850) Gin & Geneva	N/A	N/A	N/A	N/A	0.008	N/A
<b>Value (% Growth - )</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>		
(HS220830) Whiskies	45.2%	40.7%	19.4%	117.7%		
(HS220890) Other	404.9%	-82.1%	219.4%	191.3%		
(HS220840) Rum & Tafia	-96.8%	-88.3%	9489.6%	37.0%		
(HS220870) Liqueurs/Cordials	132.1%	-92.1%	-16.7%	2856.8%		
(HS220820) Grape Brandy	1366.4%	-76.4%	N/A	N/A		
(HS220860) Vodka	N/A	N/A	-69.6%	-74.0%		
(HS220850) Gin & Geneva	N/A	N/A	N/A	N/A		

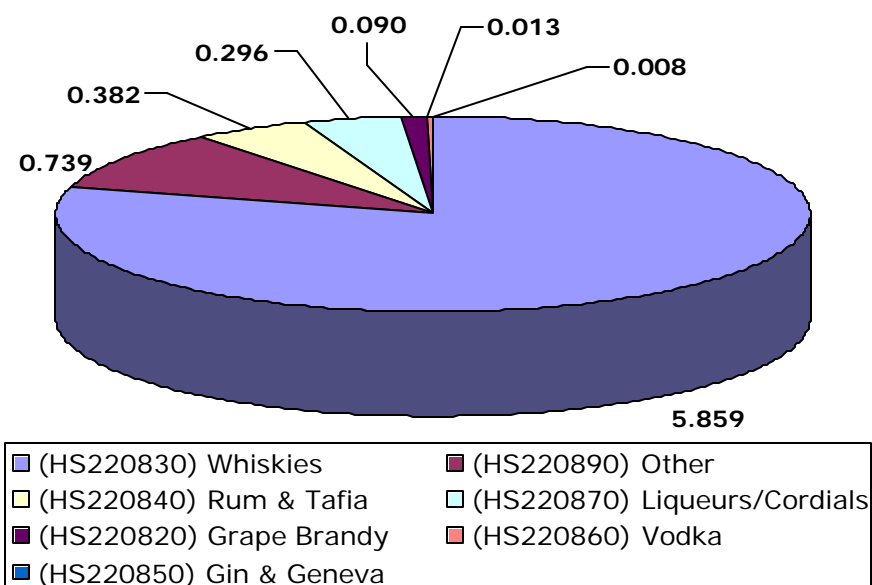
<b>Volume (Liters)</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007 YTD</b>
(HS220830) Whiskies	259,486	350,954	435,204	518,505	852,001	209,349
(HS220890) Other	31,409	215,727	29,573	85,893	79,432	39,613
(HS220840) Rum & Tafia	262,837	13,926	1,440	83,787	82,704	62,007
(HS220870) Liqueurs/Cordials	9,443	42,996	43,608	36,224	80,651	18,952
(HS220820) Grape Brandy	4,188	45,734	13,671	N/A	30,466	47,230
(HS220860) Vodka	N/A	N/A	194,201	21,883	3,374	9,441
(HS220850) Gin & Geneva	N/A	N/A	N/A	N/A	1,498	N/A
<b>Volume (% Growth - )</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>		
(HS220830) Whiskies	35.2%	24.0%	19.1%	64.3%		
(HS220890) Other	586.8%	-86.3%	190.4%	-7.5%		
(HS220840) Rum & Tafia	-94.7%	-89.7%	5718.5%	-1.3%		
(HS220870) Liqueurs/Cordials	355.3%	1.4%	-16.9%	122.6%		
(HS220820) Grape Brandy	992.0%	-70.1%	N/A	N/A		
(HS220860) Vodka	N/A	N/A	-88.7%	-84.6%		
(HS220850) Gin & Geneva	N/A	N/A	N/A	N/A		

<b>Avg. Price (\$ / Liter)</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007 YTD</b>
(HS220830) Whiskies	\$4.25	\$4.56	\$5.18	\$5.19	\$6.88	\$6.70
(HS220890) Other	\$2.81	\$2.06	\$2.69	\$2.96	\$9.31	\$9.91
(HS220840) Rum & Tafia	\$2.96	\$1.79	\$2.02	\$3.33	\$4.62	\$5.04
(HS220870) Liqueurs/Cordials	\$6.92	\$3.53	\$4.35	\$2.74	\$3.67	\$6.30
(HS220820) Grape Brandy	\$2.51	\$3.37	\$2.66	N/A	\$2.96	\$6.26
(HS220860) Vodka	N/A	N/A	\$0.83	\$2.23	\$3.76	\$9.63
(HS220850) Gin & Geneva	N/A	N/A	N/A	N/A	\$5.39	N/A
<b>Avg. Price (% Growth - )</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>		
(HS220830) Whiskies	7.3%	13.6%	0.2%	32.6%		
(HS220890) Other	-26.7%	30.6%	10.0%	214.5%		
(HS220840) Rum & Tafia	-39.5%	12.8%	64.9%	38.7%		
(HS220870) Liqueurs/Cordials	-49.0%	23.2%	-37.0%	33.9%		
(HS220820) Grape Brandy	34.3%	-21.1%	N/A	N/A		
(HS220860) Vodka	N/A	N/A	168.7%	68.6%		
(HS220850) Gin & Geneva	N/A	N/A	N/A	N/A		

(Source: U.S. Trade Data, U.S. Department of Commerce)

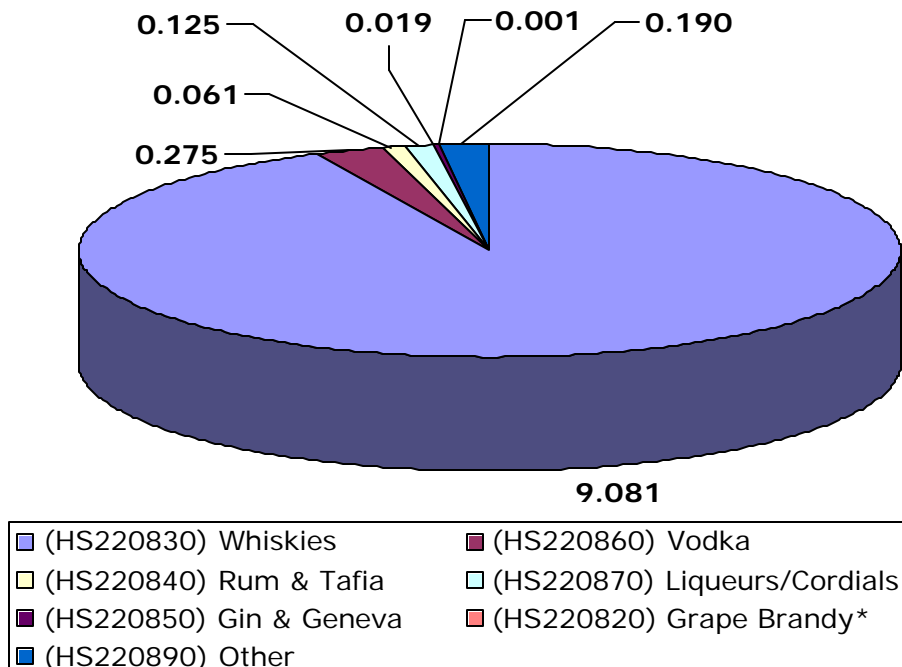
## Appendix III. Discrepancies between U.S. and China Data

U.S. Spirits Exports to China, 2006 (\$ Millions) – U.S. Data

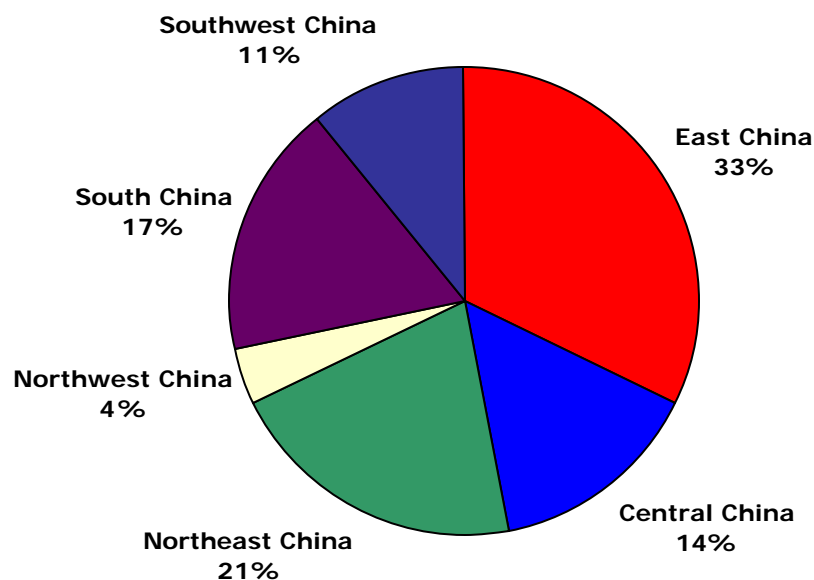
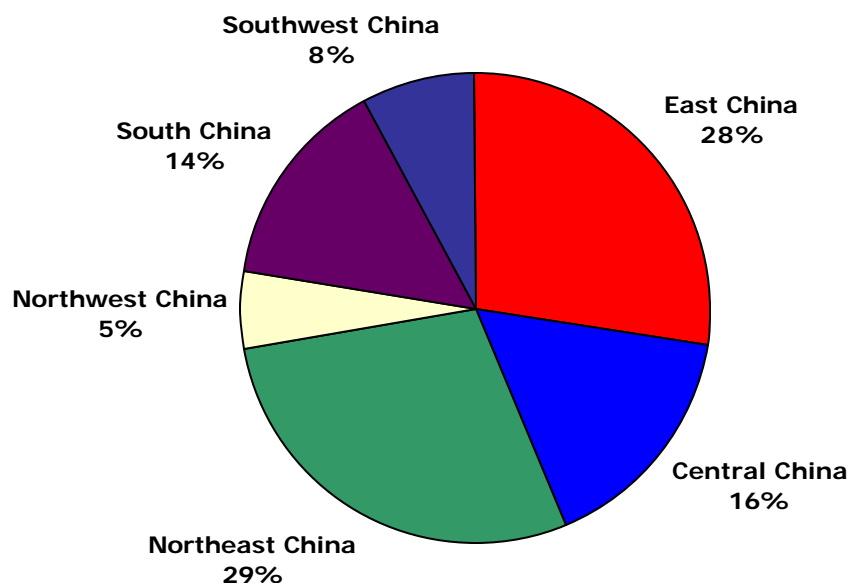


(Source: U.S. Trade Data, U.S. Department of Commerce)

U.S. Spirits Exports to China, 2006 (\$ Millions) – China Data

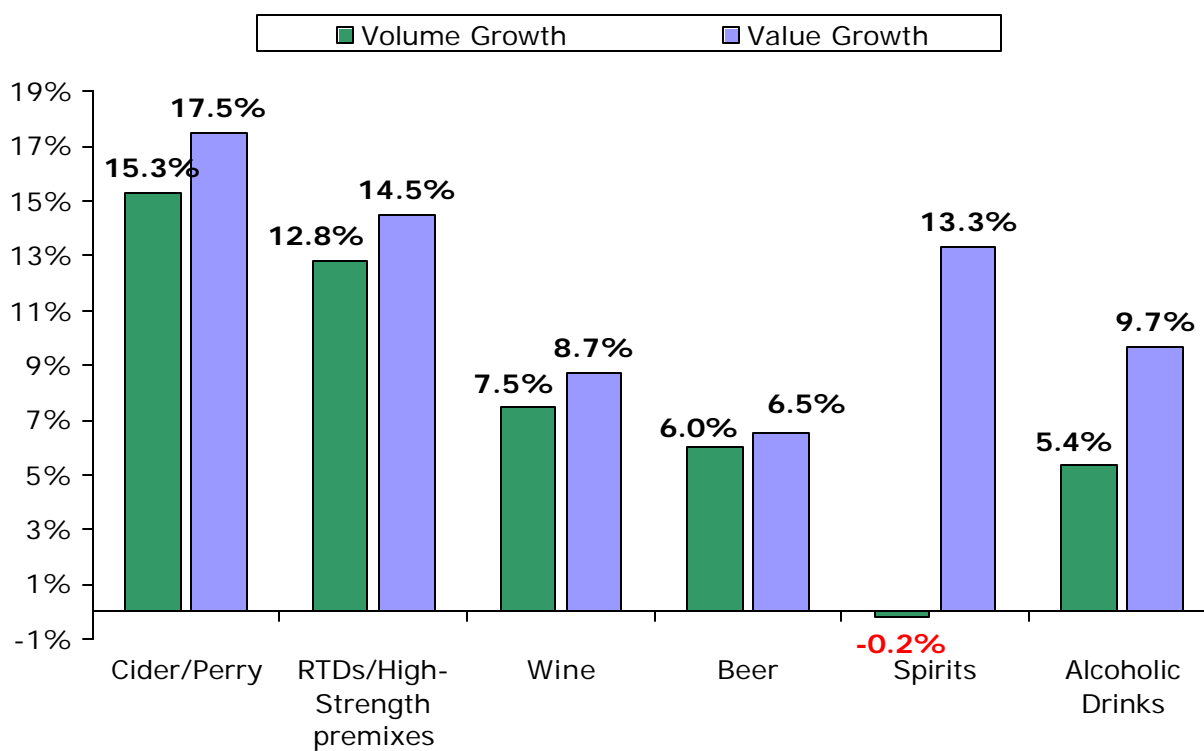


(Source: Chinese Customs Data)

**Appendix IV. China's Alcoholic Drink Sales by Region***(Refer to earlier glossary for region descriptions)***Regional Breakdown (%) of Alcoholic Drink Sales by Current Value, 2006****Regional Breakdown (%) of Alcoholic Drink Sales by Volume, 2006***(Source: Euromonitor International)*



## Appendix V. China's 2005-2006 Sales Growth of Alcoholic Drinks



(Source: Euromonitor International)